BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

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In the Matter of	)	
	)	
Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54 - 63.58	)	CC DOCKET NO. 87-266
	)	
and	)	
	)	RM-8221
Amendments of Parts 32, 36, 61, 64, and 69 of the Commission's Rules to Establish and Implement Regulatory Procedures for Video Dialtone Service	)	

COMMENTS OF THE

MICHIGAN PUBLIC SERVICE COMMISSION STAFF

Introduction

On October 20, 1994, the Federal Communications Commission (FCC) adopted a Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking in this docket. In this order the FCC considers petitions for consideration of their 1992 Second Report and Order, as well as a joint petition for rulemaking filed by the Consumer Federation of America (CFA) and the National Cable Television Association (NCTA) seeking video dialtone(VDT) specific cross-subsidy rules. In this order the FCC also takes actions to strengthen its video dialtone policies. The Michigan Public Service Commission (MPSC) staff herein submits its comments to the FCC's Third Further Notice of Proposed Rulemaking in this docket which are to be filed by December 16, 1994.

History of Video Dialtone Proceeding:

Prior to FCC Docket No. 87-266, the FCC Rules and the 1984 Cable Act prohibited a telephone common carrier from providing video programming directly to subscribers in its telephone service area, either directly or through an affiliate.

FCC Docket No. 87-266 First Report and Order, October 1991, provided for application of the rules to LECs and not IXCs so that IXCs were then eligible to become cable operators. No cable TV franchise is required for LECs to provide VDT nor for its customer programmers. In the Second Report and Order in August 1992, the FCC modified the telco/cable cross-ownership rules to permit, but not require, local telcos to participate in the video marketplace, consistent with the Cable Act, through VDT.

Under VDT, local telcos wishing to offer VDT must make available to multiple service providers, on a non-discriminatory common carrier basis, a basic platform that will deliver video programming and potentially other services to end users. Local telcos are permitted to provide non-common carrier and enhanced services to customers of the basic platform. Local telcos can enter into beneficial non-controlling relationships with video programmers that are customers of, interconnect with, or share construction of the basic platform. Local telcos are subject to existing safeguards against anticompetitive conduct and may own up to 5% of video programmers. Local telcos are prohibited from purchasing cable facilities in their service areas for purposes of providing VDT.

On October 20, 1994 the FCC adopted an order in this docket affirming and modifying video dialtone rules and requests comment on certain issues. In the Memorandum Opinion and Order on Reconsideration that was adopted, the FCC addressed petitions for reconsideration of the 1992 Second Report and Order, which adopted the rules and regulatory framework governing telephone company provision of video dialtone services. The FCC denied the joint petition by the CFA and NCTA for a rulemaking. The FCC also issued a Third Further Notice of Proposed Rulemaking to solicit additional information and comment on a number of issues.

In this order, the FCC modifies its determination that it has exclusive jurisdiction over all video dialtone services. It holds instead that it has jurisdiction only over LEC transmission of video communications that are broadcast over radio waves or that are transmitted across state boundaries. The FCC also announced that it will begin a Notice of Inquiry focusing on the implications for the jurisdictional separations process of the introduction of new technologies, including broadband capabilities, into the local telephone networks.

Video Dialtone Related Matters:

On August 26, 1994, the U.S. Court of Appeals in Washington upheld an FCC ruling that "neither a telephone company nor a customer-programmer engaged in the provision of video dial-tone service is subject to the franchise requirement of the Cable Act of 1984." But it found that the Commission "reasonably interpreted the Act to require that an entity obtain a cable franchise only when that entity selects or provides the video programming to be offered."

Bell Atlantic and US West each have successfully challenged the constitutionality of the cable-telco cross-ownership ban in federal district courts in their particular service areas. MCI has asked the FCC to reconsider its Bell Atlantic VDT Order.

The joint petition that the FCC denied in this Order on Reconsideration was a Joint Petition for Rulemaking and Request for Establishment of a Joint Board was filed by the Consumer Federation of America (CFA) and the National Cable Television Association (NCTA) on April 8, 1993. The petition stated that in the FCC's VDT Order, several critical issues were left unresolved. Those included jurisdictional separations, cost allocation, pricing and consumer safeguards. The petition requested a rulemaking to establish separations, cost accounting and cost allocation rules. The FCC initiated a rulemaking proceeding RM-8821 and requested comments. Several state regulatory commissions as well as NASUCA and NARUC urged the FCC to adopt the changes requested by the Joint Petitioners in comments that were filed with the FCC.[1]

In an October 5, 1994 letter to FCC Chairman Reed Hundt, a coalition of cable TV, consumer, and interexchange carrier interests urged the FCC to adopt effective cost allocation rules applicable to any VDT application, coordinate the provision of VDT services with removal of local competition barriers, and establish, with the states, a procedure for separating the costs of integrated facilities between the federal and state jurisdictions. The coalition warned the FCC that unless cost allocation safeguards are adopted, telephone companies could cross-subsidize VDT system construction with as much as $400 billion to $700 billion of ratepayer revenue. The Center for Media Education, the National Cable Television Association, and MCI Communications Corp. also participated in the press briefing.

The National Association of State Utility Consumer Advocates (NASUCA), a coalition ally, sent its own letter to the FCC the same day. NASUCA believes it is essential for the FCC to determine an appropriate method of cost allocation for this network. The group argued that consumers without access to VDT services, and those choosing not to subscribe must not be forced to pay costs incurred to provide VDT service. NARUC also sent a letter to the FCC on October 4, 1994 stating that is imperative that the FCC expeditiously address, through referral to a federal-state joint board, the jurisdictional cost allocation issues associated with VDT service.

The FCC in this order grants the CFA and NCTA Joint Petition for rulemaking to

[1]Those parties included the D.C. Public Service Commission, the People of the State of California and the Public Utility Commission of the State of California, the Indiana Utility Regulatory Commission and the Michigan Public Service Commission Staff, the New York Department of Public Service, NARUC, NASUCA and Compuserve, Inc.

the extent it requests that the FCC begin a rulemaking to establish a price cap basket for VDT services. The FCC denies the petition for rulemaking to the extent it asks that the FCC issue a Notice of Proposed Rulemaking proposing service-specific cost allocation rules for VDT service and establish immediately a Federal-State Joint Board to address jurisdictional separations issues. The FCC requires carriers to : (1) establish subsidiary accounting records to capture video dialtone revenues, investment, and expenses; (2) file revisions to their Cost Allocation Manuals (CAMs) for their provision of nonregulated video dialtone services; and (3) obtain any necessary waivers of the Part 69 rules prior to tariffing VDT service offerings. In addition, the FCC directs the Common Carrier Bureau to develop a data collection program to monitor the effects of VDT on separations results and on local telephone rates. The FCC also announced it's intention to open an inquiry into the impact of the introduction of new network technologies on the jurisdictional separations process.

Comment Areas:

In this order the FCC specifically seeks information and comment on: (1) mechanisms for addressing the apparent short-term constraints on the expandability of analog channel capacity; (2) modifications to the prohibition on acquisition of cable facilities and a corresponding modification to the non-ownership affiliation rules; (3) proposals that the FCC require or permit LECs to provide preferential video dialtone access or rates to certain classes of video programmers; and (4) possible changes to the rules governing pole attachments and conduit rights.

MPSC Staff Comments:

The FCC seeks comment on the merits of the GTE approach or some variation of it as a way of meeting the FCC's capacity and expandability goals. Parties commenting on this approach should address , in particular, the technical, economic, and operational feasibility of digital equipment and facilities.

The FCC seeks comment on methods or arrangements for promoting more efficient use of analog channel capacity - channel sharing arrangements. If channel sharing is permitted, who should structure or administer shared channels -- the LEC, a programmer-customer, a consortium of programmer-customers, or an independent third party? What criteria should be used to select the shared channel administrator? How should programming be selected for the shared channels? What terms and conditions on which shared channels should be made available to programmer-customers?

The MPSC staff comments here that the companies should be encouraged to move away from traditional analog CATV services and move toward switched analog or digital services. If customers are given the ability to switch and select by equal access different programs, then the issue of capacity becomes mute.

The FCC seeks comment on appropriate modifications to the prohibition that would permit acquisitions of cable facilities in markets in which two wire-based multi-channel video delivery systems are not viable, while preserving the ban in other markets. The FCC is proposing to amend the prohibition so that LECs would be permitted to purchase cable facilities in markets that meet these criteria. The FCC also proposes to amend the rules to permit LECs and cable operators jointly to construct a VDT system in those areas in which the FCC permits LECs to acquire cable facilities for use in providing video dialtone.

The MPSC staff feels that such acquisitions should be required to maintain detailed subaccounting records, property records and publish in ARMIS the details of such data related to each segment of the business.

The FCC has found that the record does not provide an adequate basis for deciding whether to mandate preferential VDT access or rates for certain classes of programmers, or whether to permit LECs voluntarily to provide preferential treatment to certain programmers. The FCC seeks additional information and comment so as to obtain a better factual basis for addressing these issues.

The MPSC staff is of the opinion that schools and nonprofit groups that use the facilities for public training, education or public meeting access should be allowed preferential rates, along with libraries, government and healthcare information services.

Pole attachments and conduit rights - Commenting parties should address whether LECs have the incentive and ability to leverage their control over pole attachments or conduit rights to prevent facilities-based competition by video programmers to the LECs' video dialtone platforms.

The MPSC staff comments that not only do the LECs have the incentive and ability , but so do the power companies. Pole attachment and conduit rights should be a common carriage service tariffed to all who have obtained proper state and local authority to construct facilities. The FCC should work with state and local authorities to develop model tariffs.

On November 11, 1994 the MPSC staff authored a paper for the National Association of Regulatory Utility Commissioners (NARUC) Communications Subcommittee meetings and workshop on video dialtone cost allocations. Some of the analysis for that paper is included here as part of the MPSC staff comments to this proceeding.

<u>Fundamental Issues Raised by 214 Applications:</u>

1. Whether VDT offerings should be subject to fully distributed or incremental cost standards;
2. the proper allocation of costs between video and telephone service, especially related to universal service cost support as the current rules allow the support;
3. the effect on basic ratepayers from the misallocation of expenditures of video dialtone;
4. the application of the FCC's accounting rules in the VDT context;
5. the establishment of a Joint Board;
6. the development of privacy rules and other rules to safeguard consumers;
7. the development of procedures for the introduction of competition;

8. how different market providers are required to cost out similar functions (ie. telco,CATV, satellite);
9. and technological redlining.

Current Method of Jurisdictional Separation:

In 1930, the United States Supreme Court "established the principle of "actual use" or "relative use" as a proper basis for such separations..."

In Smith v. Illinois Bell Telephone Company, 282 U.S. 133 the Supreme Court held that an allocation of exchange plant to the interstate jurisdiction is appropriate:

> "...while the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential...it is quite another matter to ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden...We think...that by some practical method the different uses of the property may be recognized and the return properly attributable to the intrastate service may be ascertained accordingly."

The process of selecting a method of implementing the United States Supreme Court decision in Smith v. Illinois Bell to recognize "the actual uses to which the property is put" led to the development of the so-called "use principle" in separations and settlements studies. Some form of relative use of plant thus became a tool for assisting in defining jurisdictional divisions of costs (until the FCC in CC Docket 80-286 prescribed a Gross Allocator for NTS local loop subscriber plant).

The FCC in paragraph 218 of this order states that "Moreover, we expect LECs to include in direct costs a reasonable allocation of other costs that are associated with shared plant used to provide video dialtone and other services. We will scrutinize the basis on which those costs are identified and included in the proposed charges. A LEC allocating an extremely low proportion of these other costs of shared plant to video dialtone will be expected to provide a strong justification for that approach, and we do not anticipate accepting a 0% allocation of the common costs of shared plant as reasonable."

This is unacceptable and does not conform to current jurisdictional separations rules and must be reviewed in the federal-state joint board process before implementation. The MPSC staff would again reassert its opinion that it is imperative to address the jurisdictional cost allocation issues associated with VDT service through the federal-state joint board process.

Existing Accounting and Cost Allocation Rules Inadequate:

The rules[2] under which costs are accounted for and allocated have been made obsolete by technological change and the emergence of competition. The costs of specialized network components must be placed in existing Part 32 accounting codes and in some cases, the assignments are arbitrary and at the discretion of the LECs, for example RAO 21. The rules and policies designed to ensure reasonably priced services (eg. price caps and separations) are inadequate. The FCC's accounting rules do not reflect new organizational structures and technological realities. The FCC has modified the accounting rules for joint costs, tax allocations, litigation expenses, pay telephone expenses and settlement expenses but has ignored technological changes.[3] The FCC should also modify ARMIS to report video dialtone specific information and make it electronically available. The FCC should modify jurisdictional cost allocations to properly identify VDT. The FCC's assumption that the VDT costs can be properly identified with the current rules is flawed.

Accounting Conditions as Addressed by FCC in New Jersey Bell VDT Order:

Per paragraph 42 of FCC's order authorizing New Jersey Bell's (NJB) VDT application (File No. WPC 6840), the FCC states "As in Wisconsin Bell , we condition this authorization on the requirement that NJB establish subsidiary accounting records to capture the revenues, investments and expenses associated with the provision of video dialtone service. These subsidiary accounting records shall include the direct costs and overheads associated with video dialtone service. A summary of these records shall be reported to the Commission on a quarterly basis. . . . of course, as generally required by our cost allocation rules, any enhanced and non-common carrier services must be reflected in NJB's Cost Allocation Manual (CAM) , and we condition its authorization by requiring NJB to make revisions to its manual to ensure that the costs of nonregulated ventures are segregated from the costs of regulated activities in order to prevent any cross-subsidization. At a minimum, we require NJB to revise its CAM to include a list of all accounts affected by its provision of nonregulated video dialtone services and a description of each of those services."

The potential problem with this is that NJB has already made the investment and collected many if not most of the expenses under the current rules. This makes it difficult to do retroactive ratemaking adjustments as the expenses

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[2]FCC Part 32, Uniform System of Accounts, added to Title 47 of the Code of Federal Regulations by a May 15, 1986 order and became effective January 1, 1988, CC Docket No. 78-196 Report and Order, 51 Fed. Reg. 43498, December 2, 1986. FCC Part 36 Rules, Jurisdictional Separations Procedures, added to Title 47 of the Code of Federal Regulations by a May 1, 1987 Order. FCC Part 64 Rules, Miscellaneous Rules Relating to Common Carriers, Cost Allocation Order, Released 10/16/87, CC Docket No. 86-111, Order on Reconsideration, 2 FCC Rcd 6307 (1987).

[3]NECA Annotated FCC Rules, Revised as of August 1, 1994, page i.

have already been paid by the existing customers. Also, to the extent that all of the direct and overhead costs associated with VDT are not identified, the remainder will "fall" to existing categories and paid for by existing customers.

Redlining, VDT and Universal Service:

For residential customers, affordable is a relative term based upon family income. The 1992 national average residential telephone rate for flat rate service, including subscriber line charges and taxes, was $18.66. However, most states have service options available that are lower than one-party, unlimited, flat rate service. For this same time period, the national average of the lowest recurring service rate generally available was $6.24. Policy makers have recognized that for low income customers, explicit funding assistance is required to assure that rates for "plain old telephone service" are affordable. Two principal programs have been implemented, Lifeline and Link Up, to defray the costs of telephone service for low income subscribers.

As the definition of the universal service concept evolves over time to include upgraded service/technical features, the associated costs of telephone service could increase (current statistics show that the cost of the local loop is increasing which may be one indicator that VDT costs are being included in the loop cost used to calculate today's high cost fund). To assure that all subscribers, including low income customers, can afford to subscribe to telephone service, these financial assistance programs must continue to be available. If VDT costs are considered essential services, then the current policies for cost allocations may be adequate, however, if the policy is not to subsidize VDT costs then the current policies and rules many not be adequate.

The rates for the "essential services" must be affordable, meaning that anyone wishing to subscribe to an essential service would be able to do so. To the extent that essential service would require financial support, all service providers would be required to bear their proportional contribution. Financial support should continue to be provided to carriers (as opposed to providing payments directly to subscribers) since the carriers would continue to have an obligation to provide essential service for which they should be entitled to obtain needed financial support. The Joint Board is reviewing the issue of High Cost Fund - Dial Equipment Minutes of Use Weighting and the Universal Service Fund.

Any evaluation of the benefits of advanced technology and the attendant service capabilities should be incorporated into a revised universal service concept and requires consideration of the associated costs. Presently, there is a complicated system of explicit and implicit financial support mechanisms in place to sustain universal service. The High Cost Fund, an example of an explicit subsidy, assists in keeping local service rates affordable for customers in geographic areas where the loop cost to serve is higher the national average. The payments are collected from interexchange carriers and paid to local telephone companies. Other programs, such as Lifeline and Link-up, target the low income residential consumer. Customers in some states pay a surcharge for 911 emergency service and/or telephone service for the hearing impaired. Implicit subsidies include rate averaging, cost allocations and pricing that result in cross subsidization of services and customers. To customers, most subsidies are hidden in the rates they pay.

It is fair to conclude that the costs of expanding the universal service concept beyond plain old telephone service are substantial and to some extent uneconomic, at least initially. If the conclusion were any other, then analysis of the cost implications of universal service that is presently being undertaken would be unnecessary. For example, the Joint Board is considering revisions to the High Cost Fund rules; MFS filed a petition requesting the FCC to initiate a Notice of Inquiry regarding universal service mechanisms and payments; the Alaska Joint Board has spent an extended period of time examining universal service issues as they affect the Alaska telecommunications market; the NARUC Access Issues Work Group has developed recommendations to address access charges which include recommendations on universal service funding and the NARUC Universal Service Project spent a significant amount of time trying to identify Universal Service.

In FCC proceeding DA 94-621, in the matter of the pleading cycle established for comments on a Petition for Rulemaking and Petition for Relief in Section 214 Video Dialtone Application Process, several parties commented that the FCC must take seriously the allegations made by the Petitioners and should closely examine the Section 214 applications on file in light of assertions of "electronic redlining." The FCC's own data demonstrates that universal service is not a fact. Concerns expressed by providers regarding subsidizing video dialtone service for low income or minority populations needs to be addressed. These are matters too serious to leave unaddressed unless and until they come up in the application process. Certain parties urged the FCC in this proceeding to create a Federal-State Joint Board to address these and other important concerns related to video dialtone services.

While there may not be any consensus on the magnitude of present universal service support mechanisms, there is general consensus that the costs of universal service should be as low as possible. This general precept is clearly consistent with competitive policy which favors market driven efficiencies.

Cost allocation procedures are a key factor in considering the evolution of universal service. The communications industry traditionally has had the majority of its investments assigned to unallocable joint and common costs. In the past, in a closed market, joint and common costs were recovered from all services. In an open market, this approach may place the incumbent provider at a competitive disadvantage. An explicit mechanism for recovering these costs may be required in order to eliminate this competitive disadvantage.

In order to evaluate the cost of universal service and expansion of this social goal, regulators should consider the proposal of the NARUC Access Issues Work Group for cost allocation, modified building blocks ("MBB"). MBB is an alternative to the traditional LEC long run incremental cost studies.

Elimination of Reliance Allocated Cost Support for Individual Services and Facilities:

The current reliance on cost allocation/support as a "test" for the reasonableness of a price is misplaced. Forcing LECs to allocate indirect or overhead costs, via an arbitrary cost allocation scheme, to competitive services, for the purpose of establishing a "reasonable" price provides an artificial, contrived advantage to the LEC's competitors. The LECs have incurred the burden of providing basic telephone service, including universal service, and accumulated large overhead cost structures in the process. To now penalize the LECs for those large overheads and force those same overheads to be recovered by the LECs' competitive services places the LEC in a double jeopardy situation.

In addition, it must be recognized that any cost identification or cost allocation process is only as good as the assumptions that form the basis for the system. All systems rely to some degree on averages or estimates of the cost of equipment involved or the time necessary to activate that equipment to provide a specific service. Fully distributed cost processes, such as Separations or the Part 69 cost allocation rules, not only average the cost of equipment, but average it across services. In addition, such systems provide arbitrary allocations of indirect and overhead costs to various classes of services. It must be recognized that the allocations described above are arbitrary and cannot be used to determine the "reasonableness" of prices in a competitive environment.

Cost Measurement Issues:

The simultaneous introduction of new technologies and new competitors have resulted in a desire to comprehensively reform the Part 69 rules. The new technologies offer alternative paths for providing the same service and cost reductions for providing services along existing paths. In an era of monopoly service, new technologies could be integrated into the network in a gradual manner. However, when the new technologies become a vehicle for entry by new competitors, the value of the old technologies is destroyed. Moreover, the new entrants have not been required to meet the ubiquitous deployment standard of the existing utilities. On the other hand, incumbent firms have advantages linked to huge cash flows, customer contacts, ubiquitous deployment, and control of bottleneck facilities. In this environment, Part 69 reform becomes the vehicle through which existing providers, customers and new providers attempt to enhance their immediate well-being and long term viability.

Regulators must understand how these forces impact the tools of regulation. These tools include price caps, rate base regulation, service cost studies, and jurisdictional separations procedures. Regulators must first, to highlight how these tools establish total revenues. We note that technological change has created problems for each tool examined. Second, cost methodologies for deriving service costs are examined. Several of the cost methodologies focus on only one service at a time, while others expand the focus of analysis to include a fair method of sharing joint and common cost, and the difference between embedded and forward looking costs. In determining a comprehensive reform of Part 69, we are especially eager to examine cost methodologies that provide for a fair sharing method. The single service methods are too often manipulated, either by exclusion or inclusion, to bias the study results towards the answer desired by individual conducting the study. Third, the changes in the separations process that would result from adopting any cost methodology are also investigated. It is shown that reliance on incremental cost studies could fundamentally alter the separations process.

Discussion:

Video Dial Tone Methodologies:

There appears to be a number of methodologies being discussed and probably employed by the LECs in the allocation of video dialtone costs. There has been considerable discussion regarding exactly what costs are to be included as video dialtone costs. Is it merely the purely incremental costs or should it include all costs that are not required for voice communication today? The former would probably include only the direct costs from the Optical Network Unit to the subscriber, which based on the architecture employed could be, for example, from a central point in a subdivision to each subscriber in the subdivision or could be from the nearest pole to the subscriber. (See attached chart) The direct costs might include differing amounts of joint/common and overhead costs than anticipated under "normal" separations, voice grade equivalency allocations. The latter would probably include the direct costs as well as any other upgrade that could be used for wideband application, e.g., fiber and associated electronics in both the loop and trunk, as well as broadband switching equipment. Joint/common and overhead costs might be calculated on a voice grade equivalency basis following normal separations rules. Needless to say, the costs of these two methodologies would be startlingly different. Which one, if either, is right? As in the case of most such discussions, there are fairly clear incentives underlying both philosophies. In this case, these incentives include keeping the video dialtone costs as low as possible in order to compete with other providers and thereby allocating more costs to basic local service where costs are paid for by captive ratepayers.

VDT Trials:

Although there has not been any order from the FCC regarding exactly what costs are relevant to VDT service, quasi cost rules have been emerging through the 214 application process in regards to VDT trials. Because the unregulated VDT trials and their resulting costs appear to have different treatment mandated by the FCC than the regulated commercial VDT applications and their resulting costs would logically have, there may be differing cost incentives based on whether VDT is in the trial or commercial mode.

The cost allocations for VDT are handled completely differently than wideband and broadband/CATV services offered by cable companies. Under the FCC rules for cable company allocations, costs for future VDT services will be allocated on a channel capacity basis.

Currently the costs and revenues associated with trial VDT services certified under the 214 process are to be excluded from the regulated/nonregulated ratebase, included in neither Parts 64, 36, nor 69. It is anticipated that the costs and revenues associated with commercial VDT services may be included in the regulated/nonregulated ratebase, included in Parts 64 and/or 36/69.

From a LEC standpoint, it would appear reasonable that there would be an incentive to limit as much as possible the amount of costs, especially expenses that are associated with the VDT trials. Even if the trial becomes a commercial application and therefore the costs are included in the traditional regimen, there appears to be no way that incurred expense attributed to the VDT trial can be recovered even though the trial may become a commercial application. To have these costs included in the traditional processes would appear to require some form of retroactive ratemaking which generally is not allowed. Arguably at least some of these initial expenses would provide benefit for any commercial application, e.g., construction expenses for the network not capitalized, depreciation of the equipment, changes in the billing program, training of service representatives, production of sales/marketing literature, etc. without a chance of compensation from the traditional processes once the commercial application has been approved. Assuming that at least a portion of commercial VDT will be subject to Parts 36/69, and that there will continue to be a limit on earnings for these services, the potential rewards may not offset the upfront unrecovered costs. It may be argued that the allowed earnings already are compensation enough, this issue has not been adequately addressed up to this point. Once a commercial application has been approved and there are prescribed rules addressing the cost issues, there may be more of an incentive to include more costs as a part of VDT. Because of the non-recovery possibilities of VDT trial costs by the LECs and the lack of clear rules from the FCC, it would be reasonable for VDT opponents to argue for more costs be included as trial costs.

<u>CATV Cost Allocation Rules:</u>

On February 22, 1994, the FCC adopted cost allocation rules for cable television providers pursuant to a proceeding entitled "Adoption of a Uniform Accounting System for Provision of Regulated Cable Service". These rules require the allocation of costs to nonregulated service categories to help ensure that the allocation of costs to regulated services is fair and reasonable in relation to the allocation of costs to nonregulated services. The FCC also requires that after costs are identified at the appropriate organizational level(s), cable operators shall allocate costs among the equipment basket and the following service cost categories: basic service, cable programming services,nonregulated cable programming services, other cable activities and non-cable activities. Next, the FCC requires that, to the extent possible, all costs be directly assigned among the equipment basket and the service cost categories. And for the costs that cannot be directly assigned, cable operators shall allocate such costs among the service cost categories and the equipment basket through methodologies that are consistent with the procedures in Section 76.924(f)(5) of the FCC's rules.[4]

Discussion:

As is the case with all cost allocation methodologies, none either have been, are currently, or ever will be, correct. The best that can be hoped for is reasonableness, which is usually viewed differently by different parties based on their positions at the moment. While arguably VDT is not yet a large cost, it certainly has the potential of being a reengineering of the local network to replace traditional voice grade service over time.

There is a growing recognition that different cost allocations may be appropriate for different functions. However, recovery of the fully distributed regulated costs of the LEC somewhere in the regulatory process is still expected by the LEC and is still a legal right, even under price caps. Therefore, if proper costs are not allocated to VDT, then some other regulated service is picking them up in rates that are too high and may not be receiving any of the benefit of VDT. This could produce inequitable results if technological redlining exists.

Recommended Costing Principles:

1. Long-run implies a period long enough that all costs are avoidable.
2. Cost causation is a key concept in incremental costing.
3. The increment being studied should be the entire quantity of the service provided, not some small increase in demand.
4. Any function necessary to produce a service must have an associated cost.
5. Common overheads are not part of a long-run incremental cost study. Recovery of those costs is a pricing issue.
6. Technology used in a long-run incremental cost study should be the least-cost, most efficient technology that is currently available for purchase. This assumes existing location of structural facilities, but allows for replacement with the most efficient, least-cost technology.
7. Costs should be forward looking for categorization purposes.
8. Cost studies, at a minimum, should be performed for the total output of specific services and preferably at the level of basic network functions from which services are derived.
9. The same long-run incremental cost methodology should apply to all services, new and existing, regulated and non-regulated, competitive and non-competitive.
10. Similar capacity on the same facility should have similar cost allocation.
11. Allocations should be made on the actual intended use basis which gives consideration to relative occupancy and relative time measurements.
12. Costs incurred for the purpose of providing a non-voice telephone service in the future should be allocated to that future service. This principle includes both investments and expenses, including depreciation expenses.
13. The reasonably allocated costs for video services should not depend upon

[4]FCC Proceeding MM Docket No. 93-215, CS Docket NO. 94-28, Report and Order and Further Notice of Proposed Rulemaking, Adopted on February 22, 1994.

who has jurisdiction.

14. Accounting should be detailed by technological function.
15. Cost detail should be required at the same geographic level of detail as rates.
16. Costs should be detailed in such a way to distinguish functional differences if there are differences.
17. Costs should be averaged for certain plant classes based on annual average unit costs which equate all book costs of a particular account or subaccount.
18. Cost studies should apportion costs among certain categories of network functionalities.

Conclusion:

The MPSC staff commends the FCC for the actions taken in this Third Report and Order, however, the FCC's actions do not go far enough to ensure that captive ratepayers of the regulated telephone companies are not subsidizing the video dialtone ventures of the LECs. The MPSC staff still insists that VDT specific cost allocation rules need to be developed. The MPSC staff is encouraged that with the FCC directing the Common Carrier Bureau to develop a data collection program to monitor the effects of VDT on separations results and on local telephone company rates that the proper steps will be taken to analyze this issue. The MPSC staff would recommend that the Common Carrier Bureau consider the states needs when developing a data collection program.

Respectfully Submitted,

Ronald G. Choura (rpx)

Ronald G. Choura
Policy and Planning Division
Michigan Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909
517-334-6240

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